

Essential Utilities, Inc.

(WTRG-NYSE)

Rating/Risk: Outperform/Low
Price: \$43.14 (intra-day; 1:46pm)
Target Price: \$50.00

County of Delaware vs. DELCORA: Initial hearing suggests acquisition likely to close in 2020 despite shrill rhetoric, legal maneuvering by local officials.

Summary: We attended today's Delaware County Court of Common Pleas hearing in the County of Delaware (aka DelCo) vs. DELCORA, which has major ramifications on whether Essential's acquisition of DELCORA will go forward (and if so under what terms). Contrary to rhetoric from county officials assailing any deal and privatization generally, the county's legal positions focused primarily on the structure of the ratepayer stabilization fund, leaving us with the clear impression that the case is really about who gets the money and not an effort to block the deal altogether. The attorneys agreed on a path forward that includes follow-up hearings in July-August, with hopes to conclude in the fall, and we came away believing the acquisition is likely to close in 2020.

Key Points:

- **County walks back attack on sale, focuses on ratepayer trust.** Told by the judge that he read the initial complaint as an attack on the sale of DELCORA and the ratepayer stabilization fund, DelCo lawyers seemed to backpedal, saying the complaint is meant to attack the trust and that at this time it has no issue with the sale of DELCORA per se. DelCo also seemed to walk back the immediacy of its June 3 ordinance to dissolve DELCORA, saying the authority can only be terminated once key impediments are removed, which could take months. While a lot can still happen, DelCo's legal stance on the Aqua/DELCORA deal appears far less nuclear than recent rhetoric in the local press suggests, substantially increasing the odds of the deal going.
- **DELCORA: County must honor deal even if authority terminated.** DELCORA attorneys made a persuasive argument that while DelCo does have the ability to dissolve the authority, it can only do so after honoring all contracts, which in this case encompasses the sale agreement with Aqua. DelCo's lawyers did not appear to have a ready answer to this, and the issue did not engender much further discussion with the judge, suggesting that public statements from Aqua and DELCORA that the merger agreement and rate stabilization fund are enforceable no matter who owns DELCORA are on solid legal ground. This is key, since it would render draconian press reports on the ramifications of the termination of DELCORA essentially moot.
- **Judge steering parties toward agreeing on modifications to trust.** The judge acknowledged that the structure of the ratepayer stabilization fund, and not DELCORA's sale or termination, is the key issue, noting at one point that "we don't deal with rhetoric in the newspaper, we deal with representations in court". A key point came when, at the judge's prodding, DelCo attorneys said they would be amenable to opening discussions about how to improve upon the structure of the trust. In our view, this was the clearest evidence yet that the county's opposition is really about the money trail rather than the deal itself. We believe Aqua would be open to reasonable modifications of the trust, provided they do not result in a negative financial impact.
- **Deal looks more likely to close, creating positive EPS/stock catalyst.** The key take-away is that the hearing indicated a much less extreme position on the part of DelCo than suggested by recent public meeting comments and quotes in the press. In addition to appearing to back off of attacks on the sale itself and the immediate termination of DELCORA, the county did not raise any concerns regarding the sale process itself. As a result, we now believe the DELCORA deal is likely to close in 2020, giving Essential critical mass to go after additional WW deals in PA and creating a positive earnings tailwind for 2021. We reiterate our Outperform rating for shares of WTRG, with our \$50 target price applying a P/E of 30 times, in-line with peers.

June 18, 2020

Water | Environment

EPS	2018A	2019A	2020E	2021E	2022E
Current	\$1.08	\$1.00	\$1.10	\$1.65	\$1.85
Prior	-	-	\$1.10	\$1.65	\$1.85
Consensus	-	-	\$1.38	\$1.67	\$1.79
Guidance*	\$1.53-\$1.58				

Revenue	Current	Prior	Consensus
2018A	\$838	-	-
2019A	\$881	-	-
2020E	\$1,488	\$1,488	\$1,658
2021E	\$1,668	\$1,668	\$1,948
2022E	\$1,835	\$1,835	\$2,098

Market Data

Current Price*:	\$43.14
52-Week Range:	\$30.40 - \$54.52
Market Cap. (M)	\$10,570
Shares Out. (M):	245.0
Float Shs. (M):	244.3
Inst. Ownership:	70%
Short Interest (M)	4.6
Avg. Daily Vol. (Shs.Th.):	383.9
ADTV (M):	\$16.6

Valuation (Cons.)

P/E 2020E	31.3x
P/E 2021E	25.8x
P/E 2022E	24.1x

Capitalization

Book Value / Share:	\$9.37
Net Cash / Shares:	\$0.13
Enterprise Value (M):	\$15,935.5
Dividend / Share:	\$0.94
Dividend Yield:	2.2%

*Price as-of Prior Day Close

Target Price and Rating are for 12 months.

FYE 12/30; Revenue in USD millions.

Historical and B&S EPS estimates U.S. GAAP.

*Adj. 2020 guidance reflects full year of Peoples.

Source: Capital IQ, B&S Estimates

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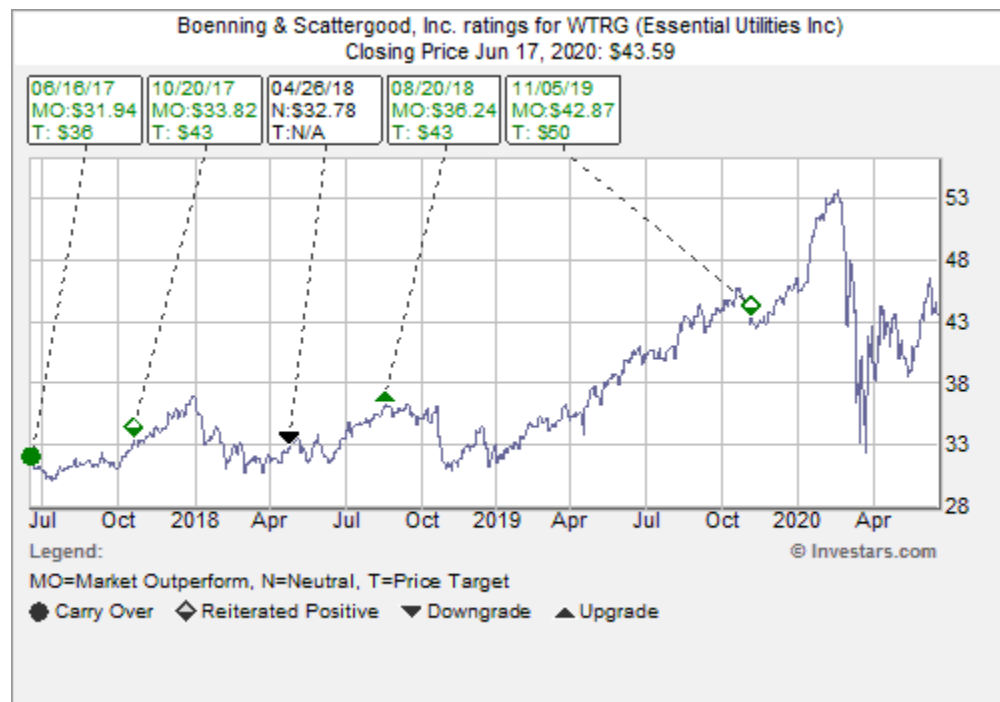
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PRICE AS OF PRIOR DAY'S CLOSE

PLEASE SEE THE IMPORTANT DISCLOSURE APPENDIX ON PAGES 2 AND 3

Disclosure Appendix

Rating and Price Target History:



Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock and prevent it from reaching our target price: regulatory lag; economic regulation; environmental law; water availability; weather; funding; and inputs.

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- **Neutral (Hold):** The security's total return over the next year or longer is expected to be roughly equivalent to the total return of the S&P 500™ over the identical period.
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Coverage Universe (a)	% of Universe	Investment Banking Clients (b)	% of Rating Group
Outperform (Buy)	28%	Outperform (Buy)	27%
Neutral (Hold)	61%	Neutral (Hold)	13%
Underperform (Sell)	0%	Underperform (Sell)	0%
Not Rated	11%	Not Rated	22%

(a) Total may not add up to 100% due to rounding.

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